

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 93-737-W/S - ORDER NO. 2000-0377
JUNE 5, 2000

IN RE: Application of Heater of Seabrook, Inc. for)
Approval of a New Water Schedule of Rates) ORDER ON REMAND
and Charges for Water and Sewer Service.)

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I. INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (the Commission) on remand from the South Carolina Supreme Court. Heater of Seabrook, Inc. ("Heater") is a water and wastewater utility operating in the State of South Carolina. This case arises from Heater's original application ("the application") (R. 376-431) for rate increase filed January 13, 1994 under Commission Docket No. 93-737-W/S. Petitions to Intervene were filed with the Commission in behalf of the Consumer Advocate for South Carolina, and the Town of Seabrook Island ("the Town"). A public hearing was held on the application on June 8, 1994, and on July 11, 1994, the Commission issued Order No. 94-644 under Docket No. 93-737-W/S, denying the rate increases (R. 3-22).

Heater appealed this decision to the Circuit Court for Richland County under Civil Action No. 94-CP-40-3479. The Commission's decision was affirmed by Order of the Honorable Thomas L. Hughston, Jr., Circuit Court Judge dated July 31, 1995 (R. 30-40). Thereafter, Heater appealed Judge Hughston's decision to the South Carolina Supreme Court. The Supreme Court reversed Judge Hughston's order and remanded the case to the Commission for further

proceedings in accordance with its opinion. Heater of Seabrook, Inc. v. Public Service Commission, 324 S.C. 56, 478 S.E. 2d 826 (1996) (Heater I). The Supreme Court specifically directed the Commission on remand to “employ a [rate setting] methodology tailored to the facts and circumstances of the case.” Heater of Seabrook, supra at 830. The Supreme Court reversed the Commission’s decision to treat availability fees as revenues and on other grounds.

By Order No. 97-114 (“the Order,” R. 54-62), dated February 21, 1997, the Commission issued its decision on remand. In accordance with the instruction of the Supreme Court, the Commission removed some \$66,000 in availability fees from the operating revenues. However, the Commission reaffirmed its decision to grant an operating margin of 8.6%. To achieve this result, the Commission granted a rate increase of \$66,000 in revenues to replace the availability fees in the operating revenue. The net result produced the same amount of revenues as was present in the original appeal. The Commission also found that operating expenses had not increased.

Pursuant to S.C. Code Ann. Section 58-5-330 (1976) and Commission Rule 103-836, Heater filed a Petition for Rehearing and Reconsideration dated March 13, 1997, requesting reconsideration of the Order. The Petition for Rehearing was denied by Commission Order No. 97-251, however, the Commission restricted its comparison of operating expenses in Order No. 97-251 to the test year for the 1992 rate case, in accordance with the directions of the Supreme Court.

Heater then timely filed its Petition for Judicial Review with the Circuit Court for Richland County under docket number 97-CP-40-1330. The appeal was heard by the Honorable J. Ernest Kinard, Jr., Circuit Court Judge, who on October 2, 1997, issued an Order affirming the decision of the Commission. Heater again appealed to the South Carolina Supreme Court, who

reversed and remanded the case a second time, 332 S.C. 20, 503 S.E. 2d 739 (1998) (Heater II).

The matter comes before us for further proceedings.

In Commission Order No. 95-9, we found the Utility had posted a sufficient surety to put its original requested rates into effect under bond, subject to S.C. Code Ann. Section 58-5-240 (Supp. 1996), which allowed the Utility the full amount of its increase under bond, pending the Court appeal. Meanwhile, the Company sold the Utility to the Town of Seabrook Island. (See Order No. 96-254, issued April 10, 1996, approving the sale). At some time after the sale, Heater of Seabrook, Inc. ceased collecting the rates under bond. Therefore, the matters to be decided here are (1) the appropriate rate setting methodology; (2) the appropriate rates and (3) the amount of refund due to the Seabrook customers from the rates collected under bond prior to the sale to the Town.

II. THE APPROPRIATE RATE SETTING METHODOLOGY

Heater's expert cost of capital witness, David C. Parcell, Executive Vice President/Senior Economist of C.W. Amos of Virginia, presented testimony regarding the appropriate price setting methodology (rate base versus operating margin). He testified that the Commission has historically regulated water and sewer utilities by use of the operating margin approach since most of these utilities have little or no rate base after contributions in aid of construction are removed. He concurs with this method in the absence of a substantial rate base. He further testifies that

“on the other hand, when a utility has a significant rate base and investor provided capital, I believe the traditional rate base rate of return approach is appropriate. I further believe this approach is proper in this proceeding since Heater of Seabrook does have a substantial rate base and investor-provided capital.” (Tr.Vol.1, P.63)

Mr. Parcell's testimony and Company Witness William E. Grantmyre's testimony are the only testimonies in the record of this case with regard to the appropriate rate making methodology to use.

Mr. Grantmyre testified that rates should be set based upon Return on Rate Base. (Tr.Vol.1, P.18) He further testified that a utility will have extreme difficulty obtaining the necessary equity and debt capital if a return is not earned on the utility's invested equity. He further testified that Heater had a very substantial rate base (\$3,920,804) for which it should be allowed to earn a rate of return. (Tr.Vol.1, P.19)

Consumer Advocate Witness Philip E. Miller with J.W. Wilson and Associates, Inc., testified with regard to use of operating margin or rate base methodology; he did not take exception to use of operating margin, but did not made a specific recommendation one way or the other. (Tr.Vol.1, P.198)

In the case of Nucor Steel v. South Carolina Public Service Commission, 312 S.C. 79, 439 S.E. 2d 270 (1994) the Court held that nothing in the plain language of Section 58-5-240 (H) requires the PSC to adopt any one particular price-setting methodology. This decision was reaffirmed in Heater of Seabrook, Inc. v. Public Service Commission, supra. Heater witnesses Parcell and Grantmyre testified that the rate base methodology should be used in this case. Their unrefuted testimonies support use of the rate base methodology as well as reasonable return on rate base.

In its instructions upon remand in Heater I, the Supreme Court cautioned this Commission to "employ a methodology tailored to the facts and circumstances of the case before it." Heater of Seabrook, supra at 830. The Court stated that the operating margin is appropriate

where a “utility’s rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction and book value in excess of investment.” Heater of Seabrook, supra at 830. The use of the operating margin is less appropriate for a utility such as Heater which has a large rate base, and which needs to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation.

III. THE APPROPRIATE RATES

All revenue and expense items involved in this case have been previously resolved with the only remaining issue being the reasonable rate of return on rate base and/or operating margin to be applied to the circumstances of this case.

In its original Application Heater asserted that the requested increase is required because of increases in purchased water costs, property taxes, wastewater treatment, chemical expenses, insurance premiums, depreciation and interest expenses, and, further, because Heater needs to earn a return on its investment.

Heater’s expert cost of capital witness David C. Parcell introduced the only testimony with regard to the reasonable return on rate base. His testimony presented the results of calculations made using three methods to estimate the Company’s cost of equity. He used the discounted cash flow (DCF) method, the capital asset pricing model (CAPM), and comparable earnings methodologies. Mr. Parcell’s average results for individual models were as follows:

DCF	10 - 11%
CAPM	10 - 10.75%
Comparable Earnings	10.5 - 11.5%

Mr. Parcell’s recommendation based upon these detailed analyses was a return on equity of between 10% and 11.5%. His testimony recommends the use of the mid-point (10.75%) as

being the most appropriate cost for setting the Company's rates. (Tr.Vol. 1, P.88-89).

In arriving at a fair return on equity, the Commission applies the principle set forth in Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 602-603 (1944); and Bluefield Waterworks and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 692-73 (1923), as adopted by the South Carolina Supreme Court in Southern Bell Telephone and Telegraph Company vs. South Carolina Public Service Commission, 270 S.C. 590, 244 S.E. 2d 278 (1978). These cases provide that a fair rate of return for a utility must be one that is commensurate with returns on investments for other enterprises with similar risks which is adequate to ensure the confidence of financial markets; and which is adequate to allow the Company to maintain its creditworthiness and to allow it to attract new capital at reasonable terms. Id.

In assessing what constitutes a fair rate of return, certain financial models and methods of analysis are used to measure the expected costs of capital. Each of these models has its strengths and weaknesses. By law, the Commission is not required to use any single formula or combination of formulas in calculating the costs of capital. Id.

The decision as to what constitutes a fair rate of return involves a balancing of investor and customer interest in the exercise of expert judgment by the Commission.

The only testimony in the record of this proceeding regarding the reasonable operating margin comes from the testimonies of Consumer Advocate Witness Philip E. Miller and Heater witness William E. Grantmyre. Witness Miller testifies that:

“In the Company's last case (Docket No. 91-627-W/S), the Commission determined that a 7.12% operating margin was appropriate (Order 92-1028 at 22) and since the Company's current adjusted operating margin of 8.91% is in excess of this authorization, it is my position that the Company's requested increase in its rate and charges should be rejected by the Commission.” (Tr.Vol. 1, P.168)

Witness Grantmyre testifies on cross examination with regard to a 8.04% operating margin granted in a previous case to a sister company of Heater of Seabrook. He testified that although the operating margin is very low and inadequate, producing an inadequate return on equity, it is better to refile cases than to continue appealing them. (Tr.Vol. 2, P.4-6)

Witness Grantmyre further testifies:

“In a recent rate case of Carolina Water Service, the Commission found a 13.86% operating margin to be appropriate. If the Commission granted a 13.86% operating margin to Heater of Seabrook this would result in a 10.10% return on equity...at the low end of the range provided by Witness Parcell. Should the Commission decide this case using the operating margin methodology, the Commission should approve an operating margin after interest of at least 13.86%.” (Tr.Vol.1, P.239-240)

In considering the fair and reasonable return on equity or operating margin for use in this case, the Commission finds Witness Parcell’s expert testimony to be very credible and specific to this case. He finds a range of 10% to 11.5% return on equity to be reasonable based upon his detailed analysis.

Consumer Advocate witness Miller’s testimony only recites the operating margin granted in the last rate case and recommends no rate increase. He does not address the reasonableness of the operating margin granted in the last case or the current case.

Witness Grantmyre refers to a 13.86% operating margin granted to Carolina Water Service and testifies to its reasonableness by tying it back to a 10.1% return on equity, which is on the low end of the range supported by Witness Parcell.

Therefore, based on the evidence in the record before it and instructions from the Supreme Court, the Commission adopts a rate of return on common equity of 10.5% and the resulting operating margin of 14.63%. The return on rate base and operating margin are as

follows:

RATE BASE

<u>COMPONENT OF CAPITAL STRUCTURE</u>	<u>RATIO</u>	<u>ORIGINAL COST OF RATE BASE</u>	<u>EMBEDDED COST RATE</u>	<u>OVERALL COST RATE</u>	<u>NET OPERATING INCOME</u>
Long-term Debt	46.25%	\$1,810,273	7.40%	3.42%	\$133,960
Preferred Stock	4.26%	\$ 166,741	6.88%	0.29%	\$ 11,472
Common Equity	<u>49.49%</u>	<u>\$1,937,090</u>	10.50%	<u>5.20%</u>	<u>\$203,347</u>
	100.00%	\$3,914,104		8.91%	\$348,779

OPERATING MARGIN

Operating Revenues	\$1,468,247
Operating Expenses	<u>\$1,123,193</u>
Net Operating Income	345,054
Customer Growth	3,725
Total Income for Return	<u>348,779</u>
Operating Margin (After Interest)	<u>14.63%</u>

The total revenues granted after the first remand in Order No. 97-114 were \$1,301,249.

The revenue required to achieve the rates of return found just and reasonable herein is

\$1,468,247. The amount of increase granted by this Order is, therefore, \$166,998. These

additional revenues are accomplished pursuant to increase in water and sewer rates which we

hereby grant as shown in Appendix A, attached to this Order, and incorporated as fully herein as copies herein verbatim.

IV. AMOUNT OF REFUND

As previously stated, the Utility no longer belongs to Heater of Seabrook, Inc. but now resides with the Town of Seabrook Island. Heater of Seabrook collected considerable revenues under bond prior to the sale, however, which amount to more than the additional revenues

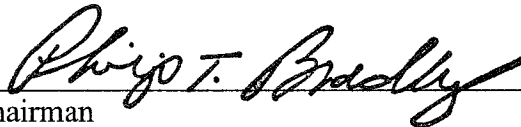
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authorized above. In accordance with our holding therefore, we hereby grant a refund to former Heater of Seabrook ratepayers in the amount of \$41,649 principal, along with \$22,041 in interest accrued through the end of May 2000, for a total refund of \$63,690. This amounts to an estimated refund of \$14.86 per residential equivalent unit (REU) of the Company. We believe that this appropriately compensates the old Heater of Seabrook customers for funds collected from them under bond.

This order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director

(SEAL)

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APPENDIX A PAGE 1

APPENDIX A

HEATER OF SEABROOK, INC.
P.O. DRAWER 4889
CARY, NC 27519
1-800-537-4865

FILED PURSUANT TO DOCKET NO. 93-737-W/S - ORDER NO. 2000-0377
EFFECTIVE DATE: JUNE 5, 2000

SCHEDULE OF RATES AND CHARGES:

WATER

1. MONTHLY CHARGE -

A. Base Facility Charge for Zero Consumption -

<u>Meter Size</u>	<u>Base Monthly Charge</u>
<1.0"	\$ 12.00
1.0"	\$ 45.00
1.5"	\$ 88.00
2.0"	\$132.00
3.0"	\$262.00
4.0"	\$490.00
6.0"	\$816.00

B. Commodity Charge - \$3.00 per 1,000 gallons

When, because of the method of water line installation utilized by the developer or owner, it is impractical to meter each unit separately, service will be provided through a single meter and consumption of all units served through such meter will be averaged; a bill will be calculated based on that average plus the addition of the basic facility charge of \$10.50 per unit and the result multiplied by the number of units served by a single meter.

2. GOLF COURSE IRRIGATION -

Golf course irrigation using untreated deep-well water subject to availability - \$.35 per 1,000 gallons.

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3. FIRE HYDRANT -

One hundred dollars (\$100.00) per hydrant per year for water service payable in advance. Any water used should be metered and the commodity charge in section one (1) above will apply to such usage.

4. NON-RECURRING CHARGES -

- | | | |
|----|--|----------|
| A. | Water service connection per single-family equivalent* | \$200.00 |
| B. | Plant impact fee per single-family equivalent | \$300.00 |
| C. | The nonrecurring charges listed above are minimum charges and apply even if the equivalency rating is less than one (1), then the proper charge may be obtained by multiplying the equivalency rating by the appropriate fee. These charges apply and are due at the time new service is applied for and/or initial connection to the water system is requested. | |

* Unless prohibited by contract approved by the South Carolina Public Service Commission.

5. RECONNECTIONS AND CONNECTIONS -

- | | | |
|----|------------------------|----------|
| A. | Water reconnection fee | \$ 40.00 |
|----|------------------------|----------|

Customers who ask to be reconnected within nine months of disconnection will be charged the monthly base facility charge for the service period they were disconnected.

- | | | |
|----|-------------------------|----------|
| B. | Customer account charge | \$ 25.00 |
|----|-------------------------|----------|

One time fee to be charged to each new account to defray cost of initiating service.

6. BILLING CYCLE -

All meters will be read and bills rendered on monthly basis in arrears, unless otherwise provided.

SEWER1. MONTHLY CHARGES -

- A. Residential - monthly charge per
single family house, condominium,
villa or apartment unit \$ 25.00

- B. Commercial - monthly charge based upon meter size:

<u>Meter Size</u>	<u>Base Monthly Charge</u>
<1.0"	\$ 31.00
1.0"	\$ 75.00
1.5"	\$150.00
2.0"	\$325.00
3.0"	\$620.00
4.0"	\$930.00
6.0"	\$1,240.00

Commercial customers are those not included in the residential category above and include but not limited to hotels, stores, restaurants, offices, etc.

2. NONRECURRING CHARGES -

- A. Sewer service connection charge per
single-family equivalent * \$200.00
- B. Plant impact fee per single-family
Equivalent \$300.00
- C. The nonrecurring charges listed above are minimum charges and apply even if the equivalency rating is less than one. If the equivalency is greater than one (1), then the proper charge may be obtained by multiplying the equivalency rating by the appropriate fee. These charges apply and are due at the time new service is applied for and/or initial connection to the sewer system is requested.

* Except as otherwise prohibited by contract approved by the South Carolina Public Service Commission.

3. NOTIFICATION, CONNECTION AND RECONNECTION CHARGES -

- A. Notification Fee: A fee of \$8.00 shall be charged each customer to whom the Company mails the notice as required by Commission Rule R.103-535.1 prior to service being discontinued. This fee assesses a portion of the clerical and mailing costs of such notices to the customers creating that cost.
- B. Customer Account Charge: One-time fee charged to each new account to defray costs of initiating service: \$17.25. If customer also receives water service, this charge will be waived.
- C. Reconnection Charge: \$250.00 pursuant to Commission Rule R.103-532.4. Customers who ask to be reconnected within nine months of disconnection will be charged the monthly base charge for the service period they were disconnected.

4. BILLING CYCLE -

Bills will be rendered monthly in arrears.

GENERAL PROVISIONS FOR BOTH WATER AND SEWER

1. SINGLE-FAMILY EQUIVALENT UNIT FOR CALCULATION OF NONRECURRING CHARGES -

- A. Water B A single-family equivalent unit is based upon a standard meter size of 5/8" and flows therefor.

Larger meter sizes increase the equivalency rating as follows:

<u>Meter Size</u>	<u>Ratio Equivalent</u>
5/8"	1.0
3/4"	2.0
1"	2.5
1 1/2"	5.0
2"	8.0
3"	16.0
4"	25.0

These equivalency ratings are to be used in calculating the water service connection and plant impact fee charges.

- B. Sewer - A single-family equivalent unit is based upon a publication of South Carolina Pollution Control Authority entitled "Guideline for Unit Contributory Loading to Wastewater Treatment Facilities" ("Guidelines") wherein suggested design of wastewater treatment plants are based upon the design assumption that a single-family unit will discharge 400 gallons of wastewater per day into the sewer collection facilities. These Guidelines will be used to calculate the single-family equivalency rating regardless of whether or not actual flows may be less. In this rate schedule the Guidelines are being used solely for determination of the sewer service connection and plant impact fee charges, not design purposes.